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Burnett, Brian ; Chen, Hui ; Gunny, Katherine

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AUDITOR-PROVIDED LOBBYING SERVICE AND AUDIT QUALITY*

Brian Burnett
California Polytechnic State University, San Luis Obispo

Hui Chen
University of Zurich

Katherine Gunny
University of Colorado, Boulder

Abstract: Regulators and the public are concerned about accounting firms lobbying politicians on behalf of their own audit clients because it could impair auditor independence. In this study, we examine whether these lobbying activities by accounting firms are associated with their clients' audit quality. Since required disclosures of lobbying activities are limited, we construct a novel proxy to capture auditor lobbying on behalf of audit clients. Using this proxy, we find that perceived audit quality is negatively related to lobbying. However, we fail to find that actual audit quality is lower for these clients. Our findings suggest that investors perceive auditors' lobbying for clients' political interests as harmful to audit quality but that these concerns do not appear to materialize in the outcome of the audit process. This evidence suggests that reputation concerns and litigation risk may provide enough discipline for auditors to maintain independence.

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* The authors' emails are burnettb@calpoly.edu, hui.chen@business.uzh.ch, and katherine.gunny@colorado.edu, respectively. We thank Scott Bronson, Shuping Chen, Mark DeFond, Yonca Ertimur, Michael Ettredge, Bjorn Jorgensen, Miguel Minutti-Meza, Terry Neal, Steve Rock, Phil Shane, Naomi Soderstrom, and workshop participants at Arizona State University, University of California at Irvine, Claremont McKenna College, University of Colorado at Boulder, University of Miami, University of Regensburg, and the American Accounting Association Annual Meeting for their feedback.

1. Introduction

Public accounting firms comprise one of the largest groups that lobby regulators at various levels of government. The lobbying arms of PricewaterhouseCoopers and Ernst &Young, for example, consistently rank among the top 20 lobbying firms in the country, based on lobbying revenue.[1] Accounting firms lobby on their own behalf and on the behalf of their clients – some of whom are also their audit clients. Their lobbying for audit clients is controversial, and politicians, regulators, and the public have repeatedly expressed concerns about it.

Recently, the Securities and Exchange Commission (SEC) investigated Ernst & Young, one of the "Big Four" accounting firms, for the lobbying service it provided for two of its audit clients, which potentially violated the auditor's rule of independence. Ernest & Young eventually paid a fine of $4 million to the SEC to settle accusations, as reported by *The New York Times* (Norris, 2014). Scott W. Friestad, the associate director in the SEC's division of enforcement, is quoted saying "Auditor independence is critical to the integrity of the financial reporting process. When an auditor acts as an advocate for its audit client, that independence is compromised. Ernst & Young engaged in lobbying activities that constituted improper advocacy and clearly violated the rules."

The political debate surrounding accounting firms providing nonaudit services to audit clients is longstanding. Some argue that nonaudit servicescould compromise auditors' independence because they create incentives for the auditors to be less stringent with their clients. In fact, many blame nonaudit services for the series of accounting scandals involving firms such as Enron and Worldcom around 2000. In response to this crisis, the SEC initiated a series of discussions scrutinizing certain auditor-provided nonaudit services, and eventually

[1]Reported by the Center for Responsive Politics.

decided to ban any nonaudit services that could potentially impair auditor independence in 2002. Lobbying on behalf of clients was included in the discussions but ultimately escaped scrutiny (Squires, 2003).

In fact, until the recent SEC investigation of Ernst & Young, there was no clear guidance whether lobbying for audit clients violates the principle of auditor independence.[2] With some nonaudit services, such as consulting, the revenue generated from the business is often a significant portion of an auditor's overall revenue. This could give the auditor incentives to acquiesce to client demands and compromise audit quality in order to retain the lucrative consulting contract. However, an auditor's revenue from lobbying services is typically quite small, which leads to the natural question why regulators are even concerned with such practice. In the case against Ernst & Young, the SEC based their disapproval of auditor-provided lobbying services on the ground of "inappropriate advocacy" of clients. Specifically, auditor lobbying for audit clients could pose an "advocacy threat" to auditor independence which could lead to lower audit quality.

Advocacy threat is one of the five threats to independence enumerated by the Conceptual Framework for the American Institute of CPAs (AICPA) Independence Standards.[3] The AICPA conceptual framework defines an advocacy threat as "actions that promote an attest client's interest or position."[4] Advocacy threats impair auditor independence when auditors promote a

[2]Although auditor-provided lobbying services were not legally forbidden at the time, several politicians and regulators have expressed concerns about the issue to the media prior to the SEC's final decision. U.S. Sen. Carl Levin called for regulatory attention on auditors lobbying in March 2012: "The [Public Company Accounting Oversight Board] should look into whether lobbying by an accounting firm is the type of service that is or should be banned under the auditor independence law." Douglas Carmichael, the former chief auditor for the PCAOB, has been quoted as saying that "lobbying members of Congress on behalf of audit clients would make the auditor an advocate for the client" (Aubin et al., 2012). On May 3, 2012, James Kroeker, then chief accountant for the SEC, said that auditors lobbying for clients may put themselves in the position of being the clients' advocates and that investors would not trust the independence of these auditors (Kroecker, 2012).

[3]The other four threats are self-interest, self-review, familiarity, and intimidation.

[4]For example, if an auditor advocates for a client to receive a loan based on the financial statements prepared and reviewed by the auditor, this could impair auditor independence. The auditor may be more inclined to represent

position to the point that their advocacy compromises their objectivity. Lobbying legislators and standard setters on behalf of clients means representing and advocating the clients' political interests, which could lead to an advocacy threat (Shaub, 2005). The auditor may lose objectivity and professional skepticism during the financial reporting process. And even if auditors do not lose their skepticism, others may perceive them as losing it which could affect actual or perceived audit quality.

On the other hand, auditors have market-based incentives to maintain their independence, protect their reputation, and reduce their litigation risk (DeAngelo 1981; Watts and Zimmerman 1983). The incentive to protect their reputation and avoid litigation may be strong enough to ensure auditors maintain their independence and provide high audit quality. As such, whether auditor lobbying for clients leads to lower audit quality remains an open empirical question.

Our study intends to empirically examine whether auditor-provided lobbying services impair audit quality. To our knowledge, no academic study has examined this issue systematically. The main reason for the lack of empirical evidence is that the officially disclosed auditor-provided lobbying services for audit clients are very limited, and does not fully represent the regulators' concern about the auditors' inappropriate advocacy of their clients. While accounting firms have strong incentives to lobby for their clients,[5] the majority of auditor lobbying for their clients is implicit (Watts and Zimmerman, 1986). That is, an accounting firm does not have to sign an explicit contract to lobby on behalf of their client and does not have to register its lobbying activities with regulators, but its political activities still promote its clients' interests.

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transactions that lead to a greater likelihood of their client receiving the loan. Other examples of advocacy threat include the auditor promoting the client's securities as part of an initial public offering or representing a client in court (Delaney and Whittington, 2011).

[5] Watts and Zimmerman (1982) propose that accounting firms' wealth is a function of their clients' wealth. Therefore accounting firms may advocate for their clients' interests as they could benefit indirectly if their clients thrive.

Following the argument provided by prior literature (Snyder, 1992; Ansolabehere et al., 2002; Ramanna, 2008; etc.), we construct a novel proxy for auditor lobbying on behalf of audit clients by analyzing the common pattern in their political action committee (PAC) contributions.[6] This proxy attempts to capture both officially disclosed and undisclosed lobbying activities. Corporate PACs strategically select politicians who hold key positions overseeing policies concerning these companies, and donate to these politicians to show their support and foster opportunities of further contacts. PACs are funded by company executives, employees, and shareholders of the firm. For example, Big 4 PAC contributions are funded almost exclusively by their own partners from local offices. Therefore, when an auditor's PAC and its client's PAC choose to make political contributions to the same politicians, we conjecture that they share similar political goals and preferences and that the auditor is more likely to lobby for positions favored by the client. As such, we measure auditor lobbying for a client as the percentage of overlap of the politicians that the auditor and the client donate to through PAC contributions. We also perform several tests to confirm the validity of this measure.

Next, we examine the relation between our measure of auditor lobbying and several commonly-used proxies of audit quality in accounting literature. We find that perceived audit quality (measured using earnings response coefficients) is negatively related to lobbying. However, we fail to find a negative association between actual audit quality (measured as the propensity to restate earnings, propensity to issue a going-concern opinion, and discretionary accruals) and our proxy for lobbying. Our evidence suggests that stock market participants

[6] American corporations are prohibited from directly giving donations to politicians by the Taft-Hartley Act of 1947. However, they are allowed to establish PACs, which are separate entities dedicated to promote the corporation's political interests. A corporate PAC solicits contributions from the affiliated company's executives, employees and shareholders, etc., and makes donations to selected politicians. Although companies are forbidden from directly contributing to their own PACs, they provide the PACs with administrative and executive support. Typically, corporate executives also serve as the chairpersons and treasurers of these PACs and are directly involved in deciding which politicians to contribute to.

perceive auditors' lobbying for clients' political interests as harmful to audit quality but that these concerns may not materialize in the outcome of the audit process.[7]

To our knowledge, our study is the first to examine the impact of auditor-provided lobbying services. Puro (1984) examines accounting firms lobbying behavior at the Financial Accounting Standards Board (FASB) level. She scrutinizes comment letters written to the FASB to identify auditing firms' lobbying positions and relates it to the auditors' underlying incentives. Several other studies examine corporations lobbying the FASB for themselves on various accounting regulations such as accounting for employers' pensions (Francis, 1987) or accounting for oil and gas production (Deakin, 1989). Other studies examine firms lobbying the SEC for themselves on accounting issues such as executive compensation disclosure rules (Lo, 2003) and the passage of Sarbanes-Oxley (Hochberg et al., 2009). Ramanna (2008) examines corporations' lobbying on fair-value accounting issues, specifically through PAC contributions to congressional members. While these studies examine how firms (clients and auditors) lobby on their own behalf, our paper is the first to examine the audit quality implications of accounting firms lobbying on behalf of their audit clients. Our setting differs distinctively from these studies.

Further, the mechanism that leads to potential impairment of audit quality in auditor-provided lobbying services is distinctly different from other nonaudit services such as consulting. Prior work that examines auditor-provided nonaudit services focuses on the auditors' incentive to obtain more lucrative consulting business at the price of possibly compromised audit quality. In contrast, we examine whether auditors' lobbying impairs auditor independence due to

[7] This result is largely consistent with the literature on whether auditor-provided nonaudit services impair auditor independence. Specifically, while Francis and Ke (2002) find a negative relation between nonaudit services and perceived audit quality, many studies fail to find an association between nonaudit services and actual audit quality (DeFond et al. 2002; Ashbaugh et al. 2003; Chung and Kallapur 2003; Larcker and Richardson 2004; Reynolds et al. 2004) while others find a negative association (Frankel et al. 2002; Markelevich and Rosner 2012; Blay and Geiger 2012).

inappropriate advocacy of their clients. It is the advocacy threat, not the economic incentive that could affect audit quality in our setting.

Our findings may provide some insight into the continuing debate on the regulation of auditor-provided nonaudit services. While the stock market reacts negatively to the perceived impairment of auditor independence, the actual audit quality may not be affected since the auditors' reputation concern and litigation risk may provide enough discipline to the profession. Thus, the regulation imposed on the auditor-provided lobbying service may serve more political, rather than economic purposes.

2. Background and Hypotheses Development

2.1 BACKGROUND

The right to petition and lobby the government regarding legislation of interest is one of the basic rights of individuals and organizations in the U.S. and is protected under the Constitution. The accounting industry, including public accounting firms and industry associations, is a powerful political interest group. It has a long history of engagement with politicians and regulators and political and regulatory outcomes (Thornburg and Roberts, 2008). According to the Center for Responsive Politics, the accounting industry, including the Big 4 auditors, engaged 160 lobbyists and spent $81 million on campaign contributions and $122 million on lobbying during the years 1998-2008, making it one of the most politically active business groups. During the same period, the AICPA, the primary industry association for the accounting industry, spent $4.56 million lobbying the federal government on accounting, banking, and tax issues. Immediately following the AICPA in the amount of lobbying spending are PricewaterhouseCoopers, Ernst &Young, KPMG, and Deloitte.

The disclosure and regulation related to corporate political activities is complex. Figure 1 summarizes the channels and levels of political activities that accounting firms can engage in. An

accounting firm can use two major channels to influence politicians and regulators. The first channel is to directly lobby legislators and members of regulatory agencies at the federal or local level. Lobbying usually involves one-to-one interactions between the lobbyist and the person of interest (or their staff members). The lobbyist communicates knowledge and provides information about a particular political issue. The second channel is to make political contributions, via PACs, to support a politician's election campaign. Generally, firms make political contributions not to sway the politicians but rather to signal support and create an entry ticket for subsequent contact and dialogue (Milyo et al., 2000). These political activities can be conducted at the federal and local level, depending on where the politician of interest holds a position. Consistent with this, Ansolabehere et al. (2002) find a strong association between these PAC contributions and lobbying expenditures; they document that groups with a lobbyist and a PAC account for 70% of all interest group expenditures and 86% of all PAC contributions.

At the federal level, both lobbying and PAC contributions are well regulated and disclosed. As required by the Lobbying Disclosure Act, the accounting firms must file regular reports with the Senate disclosing their lobbying activities, including the issues lobbied, the federal agencies contacted, the lobbyists employed, and the amount of expenses incurred. They are also required to report PAC-related information with the Federal Election Commission, including donors and recipients of the PAC funds. At the state/municipal level, the regulation and disclosure largely depends on local laws. Industry-level lobbying activities are not required to be disclosed. Although comment letters to the FASB are publicly available, whether an accounting firm writes a letter to promote a specific client's interest can only be inferred. Puro (1984) scrutinizes comment letters to the FASB and finds evidence consistent with accounting firms lobbying for their clients at the FASB level.

More importantly, any of these political activities engaged in by accounting firms could be used to implicitly lobby for audit clients since accounting firms also represent and advise audit clients on political and regulatory issues. An auditor can emphasize issues that matter to its clients even when not officially representing those clients as a contracted lobbyist.

2.2 HYPOTHESES DEVELOPMENT

The AICPA conceptual framework specifies that an advocacy threat exists when an audit firm takes "actions that promote an attest client's interest or position." Regulators are concerned about auditor lobbying for clients because it could pose an advocacy threat to auditor independence, which may hurt audit quality. For example, the congressional report on SOX recommends that auditors limit their services for audit clients to performing audits and closely related services that do not put the auditor in an advocacy position, presumably because regulators worry that lobbying could lead to lower audit quality. The SEC also states that auditors should not be placed in a position of advocacy for their audit clients, to maintain auditor independence (SEC Rule 2-01 of Regulation S-X).

However, the potential reputational damage and litigation risk may provide enough discipline for auditors so that the advocacy threat to their independence never materializes (DeAngelo 1981; Watts and Zimmerman 1983). Therefore it is an empirical question whether auditor lobbying for clients impairs auditor independence and leads to lower audit quality. We examine the association between auditor lobbying on behalf of their audit clients and perceived and actual audit quality.

Advocacy threats could impair perceived auditor independence when auditors promote a position that benefits their audit clients. The value of an audit critically depends on the market's perception of audit quality (Dopuch et al., 2003; Shockley, 1981). A perception that auditors' work is less independent will erode investors' confidence in the quality of reported accounting

information (Ryan et al., 2001; Elliott and Jacobson, 1998).[8] Auditors who lobby on behalf of their clients could, in fact, maintain independence and still face a market perception of impaired independence due to the advocacy threat. The SEC views advocacy as a potential threat to perceived auditor independence stating, "If investors were to view the auditor as an advocate for the corporate client, the value of the audit function itself might well be lost" (SEC, 2001).

Information about companies' lobbying or political contributions that is required to be disclosed is publicly available through official websites hosted by the Senate or Federal Election Commission. Watchdog organizations such as the Center for Responsive Politics also publish and analyze data on corporate political activities. This information can be disseminated in financial markets quickly and in a cost efficient manner. In fact, investors have long considered companies' political activities when making investment decisions.[9] As such, when investors observe an auditor lobbying on behalf of a client, they might question the auditor's objectivity and perceive the auditor as providing lower audit quality. Given the concerns raised by the SEC and the public on auditor lobbying for their clients, we examine perceived audit quality. This leads to our first hypothesis:

H_1: The client firms' perceived audit quality is lower when their auditors lobby regulators on their behalf.

Lobbying for clients could be associated with lower actual audit quality if auditors are more likely to acquiesce to client demands when they also lobby for the client. Prior literature provides evidence that firms use accounting flexibility to help achieve political goals (Kothari et

[8]Former SEC chief accountant Lynn Turner emphasizes the importance of perceived auditor independence saying it "not only matters, [but] it is the oxygen that keeps our profession alive." He further states that "[p]ublic faith in the reliability of a corporation's financial statements depends on the public perception of the outside auditor as an independent professional" (Turner, 2000).

[9] Hedge fund managers in Wall Street trade on information about firms' political activities (Gao and Huang, 2011; Mullins and Scannell, 2006). The Government Accountability Office's recent report on "political intelligence" documents a robust market for political information based on its research and 34 interviews with people involved with supplying, regulating, or using political intelligence (GAO, 2013).

al., 2010; Skinner, 2008; Wong, 1988). Jones (1991), for example, shows firms use earnings management to decrease reported income during import relief investigations. Ramanna and Roychowdhury (2010) likewise show firms use accounting discretion to support the politicians they are connected to by employing income-decreasing earnings management to "duck down" when their politicians face re-election. On the other hand, reputation concerns and litigation risk provide incentives for auditors to maintain independence and provide high audit quality (Watts and Zimmerman, 1983), even when lobbying for their audit client. This leads to our second hypothesis:

H_2: The client firms' actual audit quality is lower when their auditors lobby regulators on their behalf.

3. Sample Selection and Proxy for Lobbying

3.1. DATA

We obtain lobbying and PAC contribution data from the Center for Responsive Politics (CRP), which began collecting information in 1998. The CRP compiles PAC contribution information by election cycles from the Federal Election Commission's (FEC) Campaign Finance Reports and Data. All PACs are registered with the FEC and required to file reports disclosing their activities, including the donors and recipients of their funds. Corporate PACs are allowed to solicit up to $5,000 from a donor of the restricted class, such as executives and employees, and contribute up to $5,000 to a federal election candidate per election cycle. We collect the names of politicians who received contributions from our sample firms' PACs, as well as the amounts of the contributions. The disclosed lobbying data is collected through the lobbying reports compiled by CRP based on the lobbyists' semi-annually filed reports. We obtain financial information from Compustat and the Center for Research in Security Prices (CRSP). Audit information and restatements are obtained from Audit Analytics. Accounting and

Auditing Enforcement Releases (AAERs) are obtained from the Center for Financial Reporting and Management.

Our sample is constructed from the Compustat database from years 1998 to 2008. We exclude firms without PAC contributions during our sample period to control for the decision to contribute to a PAC. We exclude financial and utility firms (SIC 6000-7000 and 4400-5000) because they operate in highly regulated industries with accounting rules that differ from those in other industries. We exclude firms without the data necessary to calculate the control variables. Thus the sample used to examine actual audit quality consists of 4,868 firm-years (523 firms) between 1998 and 2008.

In addition to the sample selection procedure described above, for the perceived audit quality sample, we apply the sample selection procedure used by Ghosh and Moon (2005). Specifically, (1) we delete the top and bottom percentile of observations for the level of earnings (E), changes in earnings (ΔE), annual earnings per share, and the absolute change in annual earnings per share. (2) We remove observations with an absolute value of CAR greater than 100%. And (3) we winsorize continuous control variables at the top and bottom percentiles. These criteria result in a sample of 460 firms (3,557 firm-year observations) for the sample used to examine perceived audit quality.[10]

3.2. CONSTRUCTION OF AUDITOR LOBBYING MEASURE

There is a longstanding practice of audit clients conveying their political preferences to their audit partners. As early as 1969, the Financial Executives Institute encouraged members "to contact your outside auditors and request a meeting with the senior partners to discuss your views on the proposed [APB] opinion, and also strongly recommends that you seek to determine

[10] Our actual audit quality results (i.e. restatements, going-concern opinions, discretionary accruals) are robust to conducting the analysis on the smaller perceived audit quality sample.

the position your audit firm is taking on this issue."[11] Therefore it seems clients make recommendations to local partners in hopes that the agenda will "trickle up" to the accounting firm and its overall agenda.

We construct our proxy to capture auditor lobbying on behalf of a client by analyzing their PAC contributions. Although there are other channels firms could use to influence regulators, PAC contributions are the only channel that can link a specific corporation to a specific regulator (Snyder, 1992) and are typically followed up by direct lobbying money (Ansolabehere et al., 2002;). Corporate PACs are established with the sole purpose to fulfill the firms' political goals. They are funded by the firms' employees and shareholders, and represent these stakeholders' political interests. The PACs of the Big 4 accounting firms, without many exceptions, are financed by audit partners from local offices and follow an agenda consistent with the interest of these partners and their key clients.

As discussed earlier, corporate PACs strategically select the recipients of their political contributions. The selected regulators are typically involved with legislation that is most important to these companies. Therefore, when an auditor's PAC and its client's PAC choose to make political contributions to the same politicians, we believe that they are more likely to share similar political goals and preferences and that the auditor is more likely to lobby for positions favored by the client. Given any auditor-client pair, a highly similar list of politicians donated to

[11]A more recent example is the intense pressure clients put on their auditors related to accounting for employee stock options in the early 1990s. The largest national audit firms initially favored expensing employee stock options but reversed their opinions following intense client pressure. Walter Schuetze, chief accountant of the SEC at the time, raised the following concern: "If public companies are pressuring their outside auditors and the accounting standards executive committee (AcSEC) of the American Institute of CPAs to take particular positions on financial accounting and reporting issues and outside auditors are subordinating their views to those of their clients, can the outside auditor community continue to claim to be independent?" (Schuetze, 1994). When it was clear the FASB was going to proceed with a standard requiring expensing, companies and auditors appealed to members of Congress. The Senate passed a resolution urging FASB not to move ahead with its standard. Sen. Joe Lieberman, a Connecticut independent, went so far as to introduce a bill that effectively would have led to the FASB's demise (Zeff, 2005). The FASB ultimately issued a standard that required footnote disclosure (rather than recognition) of the expense associated with stock options.

indicates high congruence in the two firms' political pursuits. As such, we measure auditor lobbying for a client as the percentage of overlap of the politicians that the auditor and the client donate to through PAC contributions.

One natural question that arises here is whether the auditors and clients give PAC contributions to the same set of politicians but lobby for opposite views on the same issues. Milyo et al. (2000) show that PAC contributions are typically given as "entrance fees" that help gain access to a politician, instead of a bribery to buy the politician's vote. They also show a positive correlation between the politicians' voting outcome and the interest of their PAC contributors, suggesting firms give PAC contributions to politicians that already share the same views. Evidence from Ansolabehere et al. (2002) is also consistent with this theory.

One advantage of our proxy is that it captures both disclosed and undisclosed lobbying activities on behalf of clients. As discussed earlier, auditors can lobby on behalf of their clients (i.e., promote their clients' political interests) in many different ways. They do not have to lobby for their clients explicitly as their lobbyists. They can also work through informal channels that do not need to be officially disclosed. Since disclosed lobbying is only the tip of the iceberg of all potential lobbying activities, capturing unobservable lobbying is imperative to assess the effect of auditor lobbying on audit quality.

For the preceding reasons, we measure auditor lobbying for a client as the percentage of overlap of the politicians that the auditor and the client donate to through PAC contributions. More specifically, we measure accounting firms' lobbying for their clients through a variable *LOBBY_COMP,* which is measured as the proportion of overlap in political connections between auditors and their audit clients.[12] The U.S. congress has 535 members—100 senators and 435

[12] An alternative method to measure the firms' common political strategies is by their partisanship tendency revealed through PAC contributions. For example, Cooper et al. (2010) separate the total amounts of the PAC contributions

house representatives. The accounting firms in our sample donate to an average of 236 politicians per election cycle, while the client firms donate to an average of 56 politicians. For each client and accounting firm, we sort the politicians they contribute to by the dollar amount of PAC contributions and retain their top 25 politicians. The greater the PAC contribution, the more important that politician should be to the firm. Thus we only retain the top 25 politicians.[13] Next, we compare the auditors' top 25 politicians with that of each one of its clients and determine the number of politicians that overlap. Finally, our yearly proxy for lobbying, *LOBBY_COMP,* is computed as the number of politicians that overlap divided by 25. For example, if there are five overlapping politicians between the auditor and its client, *LOBBY_COMP* would be 20%. PAC contributions are disclosed on a bi-annual basis, but we compute *LOBBY_COMP* every year based on the firm's current auditor and most recent PAC information.

3.3 VALIDATION OF AUDITOR LOBBYING MEASURE

Panel A of Table 1 provides descriptive statistics on the lobbying variable. On average, there are 20.85 overlapped politicians between the auditors and their clients when counting all politicians who receive PAC contributions from our sample firms (i.e., not restricted to the top 25). When restricted to the top 25 politicians, the average number of overlapped politicians between auditors and their clients is 2.23, or a *LOBBY_COMP* of 8.9%. The highest level of alignment is 44%, which indicates 11 common politicians in the top 25.[14] Next, we provide evidence that our auditor lobbying measure captures both *disclosed* and *undisclosed* lobbying.

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made by a firm into Republican and Democratic and define the firm as Republican-leaning or Democratic-leaning. One problem with this measure is that the variation in partisanship is too small, as a majority of our sample firms are Republican-leaning.

[13] We limit the number of politicians to the top 25 but conduct additional robustness tests with the top 10, 20, and 50. The results are qualitatively similar.

[14] When two firms each independently donate to top 25 politicians out of 535 congress members, the chance of them donating to a same politician would be $\frac{25}{535}$ x $\frac{25}{535} \approx 0.0022$. Our sample firms' *LOBBY_COMP* value being an average 8.5% is thus nontrivial.

3.3.1. Disclosed lobbying activities

If our proxy captures disclosed lobbying, we would expect *LOBBY_COMP* to be associated with disclosed lobbying activities. Specifically, we collect information about lobby activities for each auditor disclosed under the Lobby Disclosure Act of 1995. We divide the sample into two groups based on disclosed lobbying activities: client firms that hire their own auditors to lobby and client firms that do not hire their own auditors to lobby. We then compare *LOBBY_COMP* across the two samples based on disclosed lobbying activities in Panel B of Table 1. We find that client firms that use their own auditors to lobby have on average (median) an overlap of 20.8% (20.0%), while client firms in the control group have on average (median) an overlap of 8.7% (4.0%). The difference between the two groups is statistically significant. Therefore it appears *LOBBY_COMP* captures disclosed lobbying activities.[15]

We also provide descriptive statistics for several variables that proxy for audit quality by firms that employ their own auditor to lobby and those that do not employ their own auditor to lobby. We find no significant difference for restatements, AAERs, going concern, discretionary accruals, or current discretionary accruals. These results are consistent with our main finding, however, since the disclosed lobbying sample is small the test could lack power to detect differences.

3.3.2. Undisclosed lobbying activities

Next, we examine whether our lobbying proxy captures undisclosed lobbying. Since these activities are not disclosed, we cannot directly examine the association. However, even though auditor's clients may not be explicitly charged for lobbying and regulation information

[15] To rule out the possibility that all Big 4 auditors have the same political strategies, we also compute the overlap of connected politicians among the Big 4 auditors. We compare each auditor's top 25 politicians with that of the other three Big 4 auditors and find the overlap ranges from 54% to 38%. It is not surprising that accounting firms have a high overlap since they are in the same industry and have common political goals. However, they seem to have distinct political agendas given the variation in the politicians they contribute to.

services, Watts and Zimmerman (1986) state "[p]otential clients probably consider these services when choosing an auditor and audit fees reflect these services." Therefore, to examine whether our proxy for lobbying captures undisclosed lobbying, we examine the association between audit fees and *LOBBY_COMP*. If our lobbying measure captures indirect lobbying, based on Watts and Zimmerman (1986), we would expect clients to be implicitly charged for these services through higher audit fees. We estimate the following model and include industry and year indicator variables:

$$\begin{aligned} log(Total\ Fees)_t \text{ or } log(Audit\ Fees)_t = {} & \beta_0 + \beta_1 LOBBY\_COMP_t + \beta_2 log(PAC)_t \\ & + \beta_3 Big4_t + \beta_4 Size_t + \beta_5 Merger_t + \beta_6 Financing_t \\ & + \beta_7 Book\text{-}to\text{-}Market_t + \beta_8 Leverage_t + \beta_9 Loss_t \\ & + \beta_{10} High\ Litigation_t + \beta_{11} ROA_t + \beta_{12} A/R\_Inventory_t \\ & + \beta_{13} Special\ Items_t + \beta_{14} Segments_t + \beta_{15} Auditor\ Tenure_t \\ & + \beta_{16} Foreign\ Ops_t + \varepsilon_t \end{aligned} \quad (1)$$

log(Total Fees)	=	natural logarithm of total fees paid to a firm's auditor.
log(Audit Fees)	=	natural logarithm of audit fees paid to a firm's auditor.
LOBBY_COMP	=	proportion of overlap in political connection between the auditor and its client, measured as the number of top 25 politicians that receive political action committee (PAC) contributions from both the auditor and its client divided by 25.
Log(PAC)	=	natural logarithm of total PAC contributions.
Big4	=	1 if the firm is audited by a Big 4 auditor (Deloitte, Ernst & Young, KPMG, Arthur Andersen, or PricewaterhouseCoopers), zero otherwise.
Size	=	natural logarithm of total assets in millions (Compustat: AT).
Merger	=	1 if the firm has engaged in a merger or acquisition (Compustat: AQC), zero otherwise.
Financing	=	1 if MA is not equal to 1 and number of shares outstanding (Compustat: SSTK) increased by at least 10%, or long-term debt (Compustat: DLTIS) increased by at least 20%, or the firm first appeared on the CRSP monthly returns database in year t, zero otherwise.
Book-to-Market	=	book value (Compustat: SEQ) divided by market value of equity (Compustat: PRCC_F*CSHO).
Leverage	=	total debt (Compustat: DLC + DLTT) divided by total assets.
Loss	=	1 if the firm reports income before extraordinary items (Compustat: IB) that is less than zero, zero otherwise.
High Litigation	=	1 if the firm operates in a high-litigation industry, zero otherwise (high-litigation industries are industries with SIC codes of 2833-2836, 3570-3577, 3600-3674, 5200-5961, and 7370-7370).
ROA	=	return on assets (Compustat: NI/AT).
A/R_Inventory	=	sum of receivables and inventories (Compustat: RECT + INVT), divided

by total assets.

Special Items = 1 if the firm reports a special item, zero otherwise (Compustat: SPI).

Segments = square root of the number of business segments of the firm (Compustat: SEG_TYPE database).

Auditor Change = one if the firm changes auditors, zero otherwise.

Foreign Ops = 1 if the firm has foreign operations, zero otherwise.

The model is estimated using ordinary least squares, and the standard errors are corrected to control for clustering across firms (Gow et al., 2010; Petersen, 2009). We use several control variables found in prior literature to affect audit fees. *Size*, *Market-to-Book*, *Segments*, and *Foreign Ops* are proxies for audit complexity. Consistent with prior research, we would expect audit complexity to be positively related to fees (Simunic, 1980; Francis, 1984). We expect total audit hours to increase with the complexity of the audit and therefore audit fees. *High Litigation*, *ROA, Leverage*, *A/R_Inventory*, *Loss*, and *Special Items* proxy for audit risk (Seetharaman et al., 2002). *Merger* and *Financing* capture the demand for additional audit services necessary to complete business combinations and obtain additional capital. We control for *Big4* since prior research has documented that a brand name price premium exists for Big 4 auditors (Francis and Simon, 1987; Francis, 1984; Palmrose, 1986; Francis and Stokes, 1986). Francis and Simon (1987) find a substantial audit fee discount in the initial year of the audit engagement. Therefore we include whether the auditor changed in a particular year (*Auditor Change*).

The sample to estimate model (1) consists of 490 firms (3,670 firm-year observations) between 2000 and 2008. Our sample starts in 2000 because firms were required to disclose audit fees starting in 2000. Table 2 presents the results. When fees are measured as total fees, the coefficient on *LOBBY_COMP* is positive and significant (coefficient = 0.625, p-value=0.01), and the results are similar for audit fees.[16] Overall, our results suggest that, if auditors are implicitly

[16] When we exclude lobbying expenditures paid to the auditor from total fees for the 41 firm-years with disclosed lobbying under the Lobbying Disclosure Act, and the results are robust.

charging clients for undisclosed lobbying activities (Watts and Zimmerman 1986), then our measure for lobbying is capturing undisclosed lobbying activities.

4. Perceived Audit Quality

4.1. REGRESSION MODEL

To examine whether investors perceive lobbying between auditors and their clients as a threat to auditor independence, we follow prior literature (e.g., Teoh and Wong, 1993; Ghosh and Moon, 2005; Chi et al., 2009; Baber et al., 2014) and infer investors' perception of auditor quality using the earnings response coefficient (ERC) estimated from the following equation:

$$\begin{aligned} CAR_t = {} & \nu_0 + \nu_1 E_t + \nu_2 \Delta E_t + \nu_3 LOBBY\_COMP_t + \nu_4 E_t * LOBBY\_COMP_t \\ & + \nu_5 \Delta E_t * LOBBY\_COMP_t + \sum_{j=1}^{10} \nu_{9+2(j-1)} E_t * CV_{jt} + \sum_{j=1}^{10} \nu_{10+2(j-1)} \Delta E_t * CV_{jt} \\ & + \sum_{j=1}^{10} \nu_{29+j} CV_{jt} + \varepsilon_t \end{aligned} \quad (2)$$

CAR = the cumulative market-adjusted returns for the 15-month period ending three months after the fiscal year-end

E = income before extraordinary items (Compustat: IB) deflated by the market value of equity (Compustat: PRCC_F*CSHO) at the beginning of the year.

ΔE = is the difference between current-year income before extraordinary items and last year's income before extraordinary items deflated by the market value of equity at the beginning of the year.

LOBBY_COMP = proportion of overlap in political connection between the auditor and its client, measured as the number of top 25 politicians that receive political action committee (PAC) contributions from both the auditor and its client divided by 25.

CV_j = Control Variables, j = 1, 2, ... 10 (discussed below):

Firm Age = number of years that a firm has been publicly traded as of fiscal year-end based on beginning dates reported in CRSP.

Big4 = 1 if the firm is audited by a Big 4 auditor (Deloitte, Ernst & Young, KPMG, Arthur Andersen, or PricewaterhouseCoopers), zero otherwise.

Growth = market value of equity plus the book value of debt (Compustat: DLC + DLTT) divided by the book value of total assets (Compustat: AT).

Persistence = first-order autocorrelation of split-adjusted income before extraordinary items per share (Compustat: EPSPXQ) for the past 16

		quarters.
Volatility	=	volatility measured as the first-order standard deviation of split-adjusted income before extraordinary items per share (Compustat: EPSPXQ) for the past 16 quarters.
Beta	=	systematic risk calculated using the past 60 monthly stock returns.
Size	=	natural logarithm of total assets in millions (Compustat: AT).
Leverage	=	total debt (Compustat: DLC + DLTT) divided by total assets.
Auditor Tenure	=	duration of the auditor-client relationship in years starting from 1982.
Log(PAC)	=	natural logarithm of total PAC contributions.

The model is estimated using ordinary least squares, and the standard errors are corrected to control for clustering across firms and time (Gow et al. 2010; Petersen 2009). Our focus is on the sign and magnitude of the sum of the coefficients on *E*LOBBY_COMP* and *ΔE *LOBBY_COMP* ($v_4 + v_5$). If the sum of these two coefficients is negative, it would be consistent with investors perceiving auditors' lobbying efforts on behalf of their own clients as impairing the auditors' independence.

Ghosh and Moon (2005) recommend using the 15-month *CAR* ending three months after the fiscal year-end to mitigate a potential downward bias in the estimated ERC due to prices leading earnings (see also Collins and Kothari, 1989).[17] Importantly, PAC and lobbying disclosures must be filed with the Senate on a semi-annual basis within 45 days of the January 1st and June 30th deadlines. We include 10 control variables and their interactions with earnings levels (*E*) and earnings changes (*ΔE*) based on Ghosh and Moon (2005). In addition, we control for firms' general lobbying activity by including *log(PAC)* and its interaction with earnings levels (*E*) and earnings changes (*ΔE*).

The remaining control variables are from Ghosh and Moon (2005). We control for firm age (*Firm Age*) because older firms are more stable and have less information asymmetry. *Big4* controls for the better reporting quality provided by big auditors. We control for four indicators

[17]Our results are qualitatively similar if we use the 12-month CAR ending three months after the fiscal year-end.

of stock value: growth opportunities (*Growth*), earnings persistence (*Persistence*), firm risk (*Volatility*), and systematic market risk (*Beta*). Firm size (*Size*) controls for any size effects. Leverage (*Leverage*) controls for firms' debt constraints. The tenure of the auditor (*Auditor Tenure*) controls for any earnings quality differences associated with the length of the auditor-client relationship.

4.2. EMPIRICAL RESULTS

We report descriptive statistics for the variables used to implement model (2) in Panel A of Table 3. The mean and median of *LOBBY_COMP* are 0.089 and 0.040, respectively, which approximates an overlap of about two politicians between a client and their auditor's top 25 politicians. The mean *CAR* is 0.020, and the median is 0.000. Our mean and median *CAR* are higher than Ghosh and Moon (2005), likely reflecting that firms with lobbying activities tend to be larger (Chen et al. 2013). Consistent with Ghosh and Moon (2005) and Chi et al. (2009), the mean *E* of 0.036 is smaller than the median of 0.050. The mean and median ΔE are similar to Ghosh and Moon (2005) at 0.001 and 0.006, respectively. Panel B of Table 3 indicates that both *LOBBY_COMP* and *CAR* are significantly correlated with many variables highlighting the need for multivariate testing.

The results of estimating model (2) are reported in Table 4. Consistent with the prior literature on ERCs, we document that earnings (*E* and ΔE) are significantly positively associated with returns ($v_1 + v_2 = 2.433$; p-value from F-test = 0.09).[18] Our main interest is in the sum of the two coefficients for *E*LOBBY_COMP* and ΔE **LOBBY_COMP*, which indicates whether lobbying is associated with the ERC. The sum of the coefficients v_4 and v_5 is -2.200 and is statistically significant based on an F-test (p-value = 0.00). This suggests that, as the lobbying

[18]We note that our coefficient estimates *E* and ΔE for are within the range of previous research. While they are larger in magnitude than the estimates of Ghosh and Moon (2005), they are a lower magnitude than Chi et al. (2009).

between auditors and their clients increases, investors place less confidence in clients' reported earnings.

We briefly discuss the other control variables documented in prior research to affect the ERC. Consistent with Ghosh and Moon (2005) and Chi et al. (2009), we conserve space by reporting only the sum of the coefficients for the control variables' interactions with E and ΔE. We find the signs of the coefficients for the following variables are consistent with prior literature but not statistically significant: *Firm Age*, *Big4*, *Beta*, *Leverage*, *Auditor Tenure*, and *log(PAC)*. The positive coefficient for *FIRMAGE* is not consistent with prior literature but is not statistically significant. Consistent with prior research, we find *Persistence* and *Size* are significantly positively associated with the ERC, while *Volatility* is significantly negatively associated with the ERC.

Overall, our results suggest that perceived audit quality is impaired when auditors act as advocates for their audit clients. When investors perceive a potential advocacy threat to auditor independence, they discount earnings when evaluating the client firms' market prices. This result partially validates concerns raised by regulators and the public about auditors lobbying on behalf of their audit clients.

4.3 ADDITIONAL SENSITIVITY ANALYSIS

An important methodological consideration is that the relations we document between political alignment, earnings, and cumulative abnormal returns might result from of an omitted determinant of the cross-section of returns that is correlated with political alignment. For example, common unobserved political risk factors simultaneously affecting both stock returns and lobbying decisions may affect all firms in the same industry. Recent work by Gormley and Matsa (2014) provides an econometric approach to control for unobserved heterogeneity that

yields consistent estimates for models with multiple, high-dimensional group effects in a computationally feasible manner. In our setting, unobserved heterogeneity (such as political risk or growth opportunities that depend on political outcomes) is of particular concern across firms and industries.

As such, we implement the iterative techniques suggested by Gormley and Matsa (2014) to control for unobserved heterogeneity across firms and industries. In untabulated results, we continue to find that the sum of the two coefficients E*LOBBY_COMP and ΔE *LOBBY_COMP is negative (-2.519) and statistically significant based on an F-test (p-value = 0.04). Thus, controlling for unobserved heterogeneity across firms and industries, we continue to find a lower earnings response coefficient when the overlap in lobbying between auditors and clients is higher.

5. Actual Audit Quality

In this section, we examine the relation between auditor lobbying for clients and the actual audit quality of these clients. We examine three measures used in the prior literature. Our first measure of audit quality is the likelihood that firms restate earnings; the second is the auditor's likelihood of issuing a going-concern opinion for financially distressed clients; and the third is the amount of discretionary accruals. Restatements capture a particularly severe form of earnings management where financial statements violate generally accepted accounting principles (GAAP), whereas discretionary accruals capture flexibility within GAAP. The propensity to issue a going-concern opinion captures the auditor's ability and willingness to accurately assess the firm's ability to continue as a going-concern. Each measure captures different aspects of audit quality.

5.1. RESTATEMENT

5.1.1. Regression model

Restatements capture a particularly severe form of earnings management whereby financial statements were not presented in accordance with GAAP. Consistent with prior literature (e.g., Cao et al. 2012; DeFond et al. 2012), we estimate the following logistic regression:

$$\begin{aligned} Restate_t = {} & \gamma_0 + \gamma_1 LOBBY\_COMP_t + \gamma_2 log(PAC)_t + \gamma_3 Size_t + \gamma_4 Book\text{-}to\text{-}Market_t + \gamma_5 Leverage_t \\ & + \gamma_6 ROA_t + \gamma_7 Loss_t + \gamma_8 Big4_t + \gamma_9 Merger_t + \gamma_{10} Financing_t + \gamma_{11} Segments_t \\ & + \gamma_{12} Foreign\ Ops_t + \gamma_{13} A/R\_Inventory_t + \gamma_{14} Return_t + \gamma_{15} High\ Litigation_t + \varepsilon_t \end{aligned} \quad (3)$$

Restate	=	1 if the firm restated its annual financial statements, zero otherwise.
AAER	=	1 if the firm was subject to an SEC Accounting and Auditing Enforcement Release, zero otherwise.
Foreign Ops	=	1 if the firm has foreign operation, zero otherwise.
Return	=	stock return over the fiscal year.

The standard errors are corrected to control for clustering across firms and time (Gow et al., 2010; Petersen, 2009).[19] We exclude 17 restatements that are quarterly, have a positive effect on earnings, or have an earnings impact less than $1 million (Defond et al. 2012).[20] In addition to restatements, we also use firms that have been sanctioned by the SEC for fraud by an AAER as an alternative measure of audit quality.[21] AAERs are obtained from the Center for Financial Reporting and Management. For the AAER sample, we exclude quarterly AAERs and those that have a positive effect on earnings.

We include *log(PAC)* to control for the relation between PAC contributions and propensity to restate. *Size* controls for any size effects. *Book-to-Market* controls for growth companies, and *Leverage* controls for firms near debt constraints because these firms may have increased incentives to manage earnings. *ROA* and *Loss* controls for the effect of performance on the likelihood of restating. We include *Big4* because prior research has shown that Big 4 auditors

[19] As a sensitivity test, we include auditor fixed effects in all our regressions and the results are robust.
[20] Our results are robust to including these 17 restatements. In addition, our results are robust to only including first-time restatements.
[21] AAERs are likely to only include cases of fraud. However, due to the limited resources of the SEC, only a subset of fraud firms will receive AAERs (Hennes et al. 2008).

tend to limit earnings management (e.g., Becker et al., 1998; Myers et al., 2003). We include indicator variables to control for the effect of mergers and acquisitions (*Merger*) and financing (*Financing*). We include *Segments* and *Foreign Ops* to control for accounting complexity. We include *A/R_Inventory* to control for the flexibility to engage in earnings management. We include litigation risk (*High Litigation*) to control for whether the firm operates in a high-risk industry, defined as industries with SIC codes 2833-2836, 3570-3577, 3600-3674, 5200-5961, and 7370 (LaFond and Roychowdhury, 2008).

5.1.2. Empirical results

Panel A of Table 5 reports the summary statistics for the variables used to implement model (4). We find that the mean *Restate* is 12.9%, which is similar to prior literature that identifies restatements using Audit Analytics and excludes quarterly restatements and those that have a positive effect on the client's financial statements.[22] Mean *AAER* is 2.1%, which is lower than mean *Restate* given AAERS occur less frequently than earnings restatements. Since we limit the sample to politically active firms, not surprisingly, our sample firms are generally large (mean *Size* = 8.156 billion), profitable (mean *ROA* = 0.037), and have positive stock returns (mean *Return* = 7.7%). Panel B of Table 3 shows the Pearson correlations among the variables. The correlation between *LOBBY_COMP* and *Restate* is negative and significant. The correlation between *LOBBY_COMP* and *AAER* is positive but not significant.

Panel A of Table 5 indicates that the Pearson correlation between *LOBBY_COMP* and *RESTATE* is negative and significant but is not significant between *LOBBY_COMP* and *AAER*. These three main variables are correlated with several other variables, however, which suggests that multivariate testing is necessary to provide further evidence.

The regression results are summarized in Table 6. The coefficient on *LOBBY_COMP* is

[22] For example, Paterson and Valencia (2011) find a 17.6% restatement rate, and Cao et al. (2012) limit their sample to Fortune 1000 firms and find a restatement rate of 10.0%.

-2.859 in the restatement model and -2.760 in the AAER model. In both models, the coefficients are negative and statistically significant. This result suggests that *LOBBY_COMP* is associated with a lower propensity of client firms to restate earnings. To mitigate concerns that these results are driven by self-selection, we split the sample into two groups based on the quintile rank of *LOBBY_COMP*. Firms in the highest quintile of *LOBBY_COMP* are propensity score matched to firms that are in the nonhighest quintile. Next, to determine the matching variables, we compare the differences in control variables (reported in Table 5, Panel A) across the two samples and find *log(PAC)*, *Size*, *Book-to-Market*, *ROA*, *Leverage*, *Loss*, and *Return* are statistically different. Therefore we calculate propensity scores derived from a probit model, where the dependent variable is one if the firm is in the highest quintile of *LOBBY_COMP* and zero otherwise and the independent variables are *log(PAC)*, *Size, Book-to-Market, ROA, Leverage, Loss, Return,* year, and industry. We then choose a match with the closest propensity score without replacement and require matches to have propensity scores within 0.10 (Armstrong et al. 2010; Lawrence et al. 2011). Based on our criteria, we can find a suitable match for 769 firm-years. The results are reported in Table 7. The univariate comparisons reveal that the matching variables are not significantly different across the two samples. More importantly, both *Restate* and *AAER* are significantly lower for firm-years in the highest quintile of *LOBBY_COMP* compared to their matched firms. These results confirm the findings in Table 6, which suggest *LOBBY_COMP* is associated with a lower propensity of client firms to restate earnings.

There are two reasons why auditor lobbying for clients could lower the probability of earnings restatement. First, Simunic (1984) suggests auditors' knowledge gained from providing one type of service may spill over to other services of the same clients. Thus lobbying for clients could lead to a positive association between auditor lobbying on behalf of clients and audit quality. Lobbying requires understanding clients' regulatory preferences and concerns

(information that is often first gathered by the local audit partner), which is likely to lead to a better understanding of political motivations for earnings management (e.g., Jones 1991; Ramanna and Roychowdhurry 2010). In-depth knowledge of clients' regulatory environment and political motivations may enhance audit quality, thereby creating a positive externality from bundling auditing and lobbying for clients.

Alternatively, the lower probability of earnings restatement may not indicate better audit quality. Recent work recognizes that we do not observe all misstatements but only those that have been detected (Wang 2013; Srinivasan et al. 2012). When the probability of detection is lower for a set of firms, then lower restatement frequency may not indicate higher reporting quality. In our setting, there are two reasons why detection risk of misstatements may be lower for firms that lobby with their own auditors. The first is that, if auditor independence is impaired by lobbying for clients, then auditors are less likely to detect misstatement of prior years, to require restatement if detected, or both. The second reason lobbying by auditors may lower detection risk of misstatements is that political pressure can reduce the probability of regulatory enforcement. Restatements are costly to both auditors and clients. Their joint political clout may reduce the probability of enforcement by regulators. Yu and Yu (2011) show that lobbying could reduce a firm's chance of being detected of fraud and deter the time of detection if eventually caught. Correia (2012) shows that politically connected firms are less likely to be involved in SEC enforcement actions and face lower penalties on average. Chaney et al. (2011) use an international dataset and find that firms with political connections have lower reporting quality without being penalized. This argument indicates that lobbying may have two effects on earnings restatement simultaneously: lower accounting quality and less chance of being caught.

5.2. GOING-CONCERN OPINIONS

5.2.1. Regression model

We examine the propensity to issue a going-concern opinion. Prior literature interprets an auditor with a lower propensity to issue a going concern opinion, ceteris paribus, as having lower audit quality. Following prior literature (DeFond et al., 2002; Carey and Simnett, 2006), we estimate the following logistic regression for companies experiencing financial distress (negative earnings or cash flows):

$$\begin{aligned} Going\ Concern_t = {} & \gamma_0 + \gamma_1 LOBBY\_COMP_t + \gamma_2 log(PAC)_t + \gamma_3 Big4_t + \gamma_4 Prob(Bankruptcy)_t \\ & + \gamma_5 Size_t + \gamma_6 Return_t + \gamma_7 Leverage_t + \gamma_8 \Delta Leverage_t + \gamma_9 Loss_t \\ & + \gamma_{10} Firm\ Age_t + \gamma_{11} Investments_t + \gamma_{12} Financing_t + \gamma_{13} CFO_t \\ & + \gamma_{14} Reporting\ Lag_t + \varepsilon_t \end{aligned} \quad (4)$$

Going Concern	=	1 if the firm receives a going-concern audit opinion, zero otherwise.
Prob(Bankruptcy)	=	probability of bankruptcy score (Zmijewki, 1984).
Δ*Leverage*	=	change in *Leverage* from t-1 to t.
Investments	=	short- and long-term investment securities (including cash and cash equivalents) (Compustat: CH + CHE + IST) divided by total assets.
CFO	=	cash flow from operating activities (Compustat: OANCF) divided by total assets.
Reporting Lag	=	number of days between fiscal year-end and the earnings announcement date.

Following DeFond et al. (2002), we include several variables that influence whether the firm receives a going-concern opinion. We include the Zmijewski score, *Prob(Bankruptcy),* to control for the probability of bankruptcy and *Size* to control for the greater negotiating power of larger firms in the event of financial distress. We include the age of the firm (*Firm Age)* because younger companies are more likely to become financially distressed. *Return* controls for the negative relation between going-concern opinions and returns. *Leverage* and Δ*Leverage* control for firms' near debt constraints. We include whether the firm had a loss (*Loss*) because these firms are more likely to fail. Cash flow from operations (*CFO*) is included because poor operating cash flows are associated with bankruptcy. *Investments* is a liquidity measure that controls for firms with more resources to prevent bankruptcy, and *Financing* controls for firms

with new financing and thus a lower probability of bankruptcy. We include *Reporting Lag* because reporting delays are associated with more going-concern opinions.

5.2.2. Empirical results

The results are reported in Table 8. The going concern rate is 7.80% (70/898), which is consistent with Defond et al. (2002) and Reynolds and Francis (2000). The coefficient on *LOBBY_COMP* is negative and not significantly different from zero. This insignificant coefficient on *LOBBY_COMP* is robust to several sensitivity tests. First, we substitute first-time going-concern opinions as the dependent variable. Second, recognizing that not all firms that have negative earnings or negative cash flows deserve going-concern opinions, we estimate model (4) on the most severely distressed quartile (based on lowest cash flow and earnings). Lastly, we propensity score match using the same procedure described to produce the results presented in Table 7.

Using the propensity to issue a going-concern opinion as a proxy for audit quality, we fail to find evidence consistent with larger values of *LOBBY_COMP* posing an advocacy threat to auditor independence. The benefit of using this measure of audit quality is that a going-concern opinion is arguably the outcome of auditing process over which auditors have the most direct input and influence. However, whether firms' fundamentals warrant a going-concern opinion could be related to information or events outside the auditor's scope, which could introduce noise into this audit quality measure. Overall, our analysis fails to find an association between auditor lobbying for clients and impaired auditor independence based on the propensity to issue a going-concern opinion.

5.3. PERFORMANCE-MATCHED DISCRETIONARY ACCRUALS

5.3.1. Regression model

In this section, we use performance-matched discretionary accruals to proxy for audit quality. Restatements capture a particularly severe form of earnings management (i.e., violations of GAAP), while discretionary accruals are intended to capture flexibility within GAAP. Larger values of *LOBBY_COMP* may pose an advocacy threat to auditor independence and the lower audit quality may manifest itself in auditors allowing greater flexibility within GAAP. To test the possibility, we implement the following model (Ashbaugh et al., 2003; Lai and Gul, 2008; DeFond et al. 2012):

$$\begin{aligned} \textit{Dis. Accruals}_t \textit{ or Dis. Current Accruals}_t = {} & \gamma_0 + \gamma_1 LOBBY\_COMP_t + \gamma_2 log(PAC)_t + \gamma_3 Size_t \\ & + \gamma_4 Book\text{-}to\text{-}Market_t + \gamma_5 Leverage_t + \gamma_6 Loss_t \\ & + \gamma_7 Big4_t + \gamma_8 Merger_t + \gamma_9 Financing + \gamma_{10} CFO_t \\ & + \gamma_{11} Lagged\ Accruals_t + \gamma_{12} High\ Litigation_t + \varepsilon_t \quad (5) \end{aligned}$$

Dis. Accruals	=	discretionary accruals estimated from the modified-Jones model less the value of discretionary accruals from a firm matched on performance.
Dis. Current Accruals	=	discretionary current accruals estimated from the modified-Jones model less the value of discretionary current accruals from a firm matched on performance.
Accruals	=	total accruals (Compustat: IBC-OANCF) scaled by beginning of year total assets.

Following Kothari et al. (2005), we estimate performance-adjusted discretionary accruals (*Dis. Accruals*) as the residual from the modified-Jones model (Dechow et al. 1995) and subtract the residual from a firm in the same year and industry with the closest return on assets. Prior research suggests that managers have the most discretion over discretionary current accruals (e.g., Becker et al., 1998; Ashbaugh et al., 2003). Thus we also estimate performance-adjusted discretionary current accruals (*Dis. Accruals*) by adding back depreciation to total accruals and excluding property, plant, and equipment from the estimation model.

We include *Big4* because prior research has shown that Big 4 auditors tend to limit extreme accruals (e.g., Becker et al., 1998; Myers et al., 2003). We include *Size* because large firms have more stable accruals (Dechow and Dichev, 2002). We include indicator variables to

control for the effect of mergers and acquisitions (*Merger*) and financing (*Financing*). We include variables that proxy for the ability and incentives of the firm to engage in accruals management: *Book-to-Market*, *Leverage*, and *Loss*. Firms that are near debt constraints and raising external financing may have greater incentives to manage earnings (e.g., DeFond and Jiambalvo, 1994; Becker et al., 1998). *Book-to-Market* controls for the difference in discretionary accruals between growth and value firms. We include *Lagged Accruals* to control for mean reversion in accruals.

5.3.2. Empirical results

The results are summarized in Table 9. The coefficient on *LOBBY_COMP* is positive but insignificant in both equations. Thus we fail to find support for the idea that auditor lobbying for clients is associated with impaired auditor independence measured by discretionary accruals. In addition, we propensity score match using the same procedure described to produce the results presented in Table 7. After propensity score matching, we fail to find significant differences between the sample of firms in the highest quintile of *LOBBY_COMP* and the control firms.

Larger values of *LOBBY_COMP* may pose an advocacy threat to auditor independence and the lower audit quality may manifest itself with respect to an earnings management incentive such as meeting earnings benchmarks but not in overall discretionary accruals. Consistent with prior research (e.g., Matsumoto, 2002; Brown and Pinello, 2007), we identify the earnings management incentive as accruals that help firms meet or beat analyst forecasts. Our specific approach follows Brown and Pinello (2007) in that we identify firms with nonnegative earnings surprises and examine whether firms that lobby with their auditors are more likely to have positive discretionary accruals that just meet or beat an analyst forecast. We estimate a logistic regression:

$$Prob(Positive\_Accruals_t=1 \mid NonNegative\_Earnings_t=1) = F(\gamma_0 + \gamma_1 LOBBY\_COMP_t$$

$$+ \gamma_2 log(PAC)_t + \gamma_3 Market\ Value_t + \gamma_4 Book\text{-}to\text{-}Market_t + \gamma_5 Loss_t + \gamma_6 |Forecast\ Error|_t + \varepsilon_t) \quad (6)$$

Positive_Accruals	=	1 if discretionary accruals controlling for performance are positive, zero otherwise[23]
NonNegative Earnings	=	nonnegative earnings surprise, which is 1 if actual earnings per share (EPS) from IBES is greater than or equal to the last consensus forecast, zero otherwise
Market Value	=	natural logarithm of the market value of equity
|Forecast Error|	=	the absolute value of the actual EPS minus the earliest consensus forecast (after last year's earnings announcement), scaled by the fiscal-year-end price

A positive coefficient on *LOBBY_COMP* would be consistent with lobbying posing an advocacy threat to auditor independence that leads to lower audit quality. *logPAC* controls for firms' general political action committee activities, and the rest of the control variables are from the model employed by Brown and Pinello (2007). Specifically, *Market-to-Book* controls for greater costs to missing analysts' forecasts for growth firms (Skinner and Sloan 2002). *|Forecast Error|* proxies for forecasting uncertainty. *Market Value* proxies for size since analyst forecasts are less optimistically biased for larger firms (Hwang et al., 1996; Brown, 1997). Avoiding a negative earnings surprise may be less important for loss firms (Degeorge et al.,1999). The coefficient on *LOBBY_COMP* (untabulated) is not significant when implementing model (6). Overall, using discretionary accruals as a proxy for audit quality, we fail to find support that auditor lobbying is related to audit quality measured by discretionary accruals to achieve an earnings benchmark.

7. Conclusion

Accounting firms lobby politicians and regulators on their own behalf and on behalf of their clients. Lobbying for clients is controversial, as it may pose an advocacy threat to actual

[23]We obtain qualitatively similar results if we define the dependent variable as one if a firm would have missed the consensus analyst forecast without discretionary accruals but meets or beats the consensus forecast with discretionary accruals.

and perceived auditor independence. Using a unique measure of accounting firms' political advocacy for clients, we examine whether it is associated with impaired auditor independence and lower audit quality. We find perceived audit quality is lower when our measure of political advocacy is high, but we fail to find evidence consistent with actual audit quality being lower using three different measures of audit quality.

To our knowledge, our study provides the first systematic examination of the impact of one type of advocacy threat presented by auditors lobbying on behalf of their own clients. When auditors advocate and promote clients' interests, they risk losing their objectivity and professional skepticism in the eyes of the investors and the public. Although we fail to find evidence that this threat to auditor independence materializes in the auditing process, investors appear to discount the usefulness of financial information when evaluating these firms' market prices. Our findings partially justify the concerns raised by regulators and the public that perceived audit quality is impaired when auditors act as the clients' advocates. However, it seems other incentives and mechanisms, such as reputation and litigation risk, may already provide enough discipline to maintain auditor independence.

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APPENDIX: Definition of Variables

Dependent and test variables:

LOBBY_COMP	=	proportion of overlap in political connection between the auditor and its client, measured as the number of top 25 politicians that receive political action committee (PAC) contributions from both the auditor and its client divided by 25.
AAER	=	1 if the firm was subject to an SEC Accounting and Auditing Enforcement Release, zero otherwise.
Going Concern	=	1 if the firm receives a going-concern audit report, zero otherwise.
log(Total Fees)	=	natural logarithm of total fees paid to a firm's auditor.
log(Audit Fees)	=	natural logarithm of audit fees paid to a firm's auditor.
Dis. Accruals	=	discretionary accruals estimated from the modified-Jones model less the value of discretionary accruals from a firm matched on performance.
Dis. Current Accruals	=	discretionary current accruals estimated from the modified-Jones model less the value of discretionary current accruals from a firm matched on performance.
Restate	=	1 if the firm restated annual earnings, zero otherwise.

Control variables:

A/R_Inventory	=	sum of receivables and inventories (Compustat: RECT + INVT), divided by total assets.
Audit Change	=	one if the firm changes auditors, zero otherwise.
Auditor Tenure	=	duration of the auditor-client relationship in years starting from 1982.
Big4	=	1 if the firm is audited by a Big 4 auditor (Deloitte, Ernst & Young, KPMG, Arthur Andersen or PricewaterhouseCoopers), zero otherwise.
Beta	=	systematic risk calculated using the past 60 monthly stock returns.
Book-to-Market	=	book value (Compustat: SEQ) divided by market value of equity (Compustat: PRCC_F*CSHO).
CAR	=	cumulative market-adjusted returns for the 15-month period ending three months after the fiscal year-end.
CFO	=	cash flow from operating activities (Compustat: OANCF) divided by total assets.
E	=	income before extraordinary items (Compustat: IB) deflated by the market value of equity (Compustat: PRCC_F*CSHO) at the beginning of the year.
|*Forecast Error*|	=	the absolute value of the actual EPS minus the earliest consensus forecast (after last year's earnings announcement), scaled by the fiscal-year-end price.
Financing	=	1 if MA is not equal to 1 and number of shares outstanding (Compustat: SSTK) increased by at least 10%, or long-term debt (Compustat: DLTIS) increased by at least 20%, or the firm first appeared on the CRSP monthly returns database in year t, zero otherwise.
Firm Age	=	number of years that a firm has been publicly traded as of fiscal year-end based on beginning dates reported in CRSP.
Foreign Ops	=	1 if the firm has foreign operations, zero otherwise.
Growth	=	market value of equity plus the book value of debt (Compustat: DLC + DLTT) divided by the book value of total assets (Compustat: AT).

High Litigation	=	1 if the firm operates in a high-litigation industry, zero otherwise (high-litigation industries are industries with SIC codes of 2833-2836, 3570-3577, 3600-3674, 5200-5961, and 7370-7370).
Investments	=	short- and long-term investment securities (including cash and cash equivalents) (Compustat: CH + CHE + IST) divided by total assets.
Lagged Accruals	=	last year's total accruals (Compustat: IBC-OANCF) scaled by beginning-of-year total assets.
Leverage	=	total debt (Compustat: DLC + DLTT) divided by total assets.
log(PAC)	=	natural logarithm of total PAC contributions.
Loss	=	1 if the firm reports income before extraordinary items (Compustat: IB) that is less than zero, zero otherwise.
Market Value	=	natural logarithm of the market value of equity.
Merger	=	1 if the firm has engaged in a merger or acquisition (Compustat: AQC), zero otherwise.
NonNegative Earnings	=	nonnegative earnings surprise, which is 1 if actual earnings per share (EPS) from IBES is greater than or equal to the last consensus forecast, zero otherwise.
Persistence	=	first-order autocorrelation of split-adjusted income before extraordinary items per share (Compustat: EPSPXQ) for the past 16 quarters.
Positive_Accruals	=	1 if discretionary accruals controlling for performance are positive, zero otherwise.
Prob(Bankruptcy)	=	probability of bankruptcy score (Zmijewki, 1984).
Return	=	stock return over the fiscal year.
ROA	=	return on assets (Compustat: NI/AT).
Reporting Lag	=	number of days between fiscal year-end and the earnings announcement date.
Segments	=	square root of the number of business segments of the firm (Compustat: SEG_TYPE database).
Size	=	natural logarithm of total assets in millions (Compustat: AT).
Special Items	=	1 if the firm reports a special item, zero otherwise (Compustat: SPI)
Volatility	=	first-order standard deviation of split-adjusted income before extraordinary items per share (Compustat: EPSPXQ) for the past 16 quarters.

Figure 1: Summary of an Accounting Firm's Political Activities

General category	Level	Example of a regulator being lobbied	Method	Disclosure requirement
Direct lobbying	Federal level	Congress member	Meeting, gathering information, etc.	Disclosed and regulated per the Lobbying Disclosure Act
	Local level	State/municipal level regulator	Meeting, gathering information, etc.	Depends on local disclosure requirements
	Industry level	FASB member	Meeting, gathering information, writing comment letters, etc.	Undisclosed, although comment letters are publicly available
Political contribution	Federal level	Congress member	PAC donation	Disclosed and regulated per the Federal Election Campaign Act
	Local level	State/municipal level regulator	PAC donation	Depends on local disclosure requirement
	Industry level	FASB member*	NA	NA

* FASB members are appointed by the Financial Accounting Foundation for a five-year term, and there is not an election campaign.

Table 1

Validation of Auditor Lobbying Proxy

Panel A: Descriptive statistics for political alignment between auditor and client (1998-2008)

	Mean	Median	Std. Dev.	Min	Max
Raw # of politicians that overlap (no amount restriction)	20.85	8.00	34.65	0.00	279.00
Raw # of politicians that overlap (top 25)	2.23	1.00	2.44	0.00	11.00
LOBBY_COMP (top 25 overlap / 25)	8.9%	4.0%	9.7%	0.0%	44.0%

Panel B: Descriptive statistics for auditor lobbying by whether firms employ their own auditor to lobby

	Firms that employ their own auditor to lobby *(n=41)*		Firms that do not emloy their own auditor to lobby *(n=4,827)*	
	Mean	Median	Mean	Median
LOBBY_COMP	20.8%***	20.0%***	8.7%	4.0%
Restate	0.07	0.00	0.13	0.00
AAER	0.00	0.00	0.02	0.00
Going Concern	0.00	0.00	0.02	0.00
Dis. Accruals	-0.07	0.00	-0.14	-0.03
Dis. Current Accruals	-0.02	-0.10	-0.21	-0.04

The sample consists of 4,868 firm-years with PAC expenditures between 1998 to 2008. */**/*** represent statistical significance at 10%/5%/1% levels two-tailed between the sample of firms that employ their own auditor to lobby and those that do not employ their own auditor to lobby. *LOBBY_COMP* is the proportion of overlap in political connection between the auditor and its client, measured as the number of top 25 politicians that receive political action committee (PAC) contributions from both the auditor and its client divided by 25. See Appendix A for variable definitions.

Table 2

Regression of total and audit fees on comprehensive lobbying and controls

$log(Fees) = \beta_0 + \beta_1 * LOBBY\_COMP + X * Control\ Variables$

	log(Total Fees)		*log(Audit Fees)*	
Constant	8.980***	(0.00)	8.942***	(0.00)
LOBBY_COMP	0.625**	(0.01)	0.635***	(0.00)
log(PAC)	-0.012**	(0.03)	-0.012**	(0.02)
Big4	0.242**	(0.04)	0.273**	(0.03)
Size	0.527***	(0.00)	0.498***	(0.00)
Merger	0.116***	(0.00)	0.086**	(0.02)
Financing	-0.021	(0.56)	-0.037	(0.30)
Book-to-Market	-0.003	(0.76)	0.003	(0.70)
Leverage	0.525***	(0.00)	0.657***	(0.00)
Loss	0.155***	(0.00)	0.131***	(0.00)
High Litigation	0.038	(0.55)	0.011	(0.84)
ROA	-0.041	(0.83)	-0.076	(0.70)
A/R_Inventory	0.475***	(0.00)	0.514***	(0.00)
Special Items	-0.005	(0.89)	0.016	(0.64)
Segments	0.371***	(0.00)	0.367***	(0.00)
Auditor Change	-0.299***	(0.00)	-0.255***	(0.00)
Foreign Ops	0.242***	(0.00)	0.254***	(0.00)
No. of Observations	3,670		3,670	
No. of Firms (clusters)	490		490	
Adj. R^2	0.758		0.794	

The sample consists of 3,670 firm-year (490 firms) with PAC expenditures between 2000 to 2008. */**/*** represent statistical significance at 10%/5%/1% levels two-tailed. p-values are in parentheses. All continuous variables are winsorized at the 1% and 99% level. See Appendix A for variable definitions.

Table 3

Panel A: Summary Statistics

Variable	Mean	Median	Std. Dev.	25%	75%
LOBBY_COMP	0.089	0.040	0.097	0.000	0.160
CAR	0.020	0.000	0.364	-0.219	0.247
E	0.036	0.050	0.082	0.023	0.070
ΔE	0.001	0.006	0.082	-0.014	0.021
Firm Age	31.234	27.000	22.823	12.000	43.000
Big4	0.978	1.000	0.147	1.000	1.000
Growth	1.621	1.193	1.331	0.859	1.870
Persistence	0.254	0.217	0.373	-0.016	0.513
Volatility	0.370	0.222	0.455	0.116	0.436
Beta	0.956	0.868	0.638	0.527	1.246
Size	8.205	8.245	1.820	6.926	9.586
Leverage	0.273	0.258	0.178	0.143	0.381
Auditor Tenure	2.269	2.485	0.843	1.792	2.944
log(PAC)	6.839	6.909	0.638	6.217	6.909

Table 3 (continued)

Panel B: Pearson correlation matrix

	LOBBY_COMP	*CAR*	*E*	*ΔE*	*Firm Age*	*Big4*	*Growth*	*Persistence*	*Volatility*	*Beta*	*Size*	*Leverage*	*Auditor Tenure*
CAR	0.04**												
E	0.08***	0.26***											
ΔE	0.00***	0.20***	0.51***										
Firm Age	0.21***	0.03*	0.13***	0.01									
Big4	0.14***	0.05***	0.06***	0.01	0.05***								
Growth	0.09***	0.18***	0.02	0.06***	-0.06***	0.01							
Persistence	0.00	0.03*	0.01	-0.03*	0.00*	0.02	0.07***						
Volatility	0.00	-0.10***	-0.29***	-0.03*	0.05*	0.04**	-0.22***	-0.10***					
Beta	-0.12***	-0.14***	-0.21***	-0.02	-0.15	0.04**	0.02	0.07***	0.20***				
Size	0.44***	0.17****	0.22***	0.09***	0.31***	0.23***	0.39***	0.03**	-0.05**	-0.06***			
Leverage	-0.04**	-0.09***	-0.12***	-0.02	-0.03	0.05***	-0.19***	-0.11***	0.16***	-0.04**	-0.11***		
Auditor Tenure	0.13***	0.03**	0.05**	-0.01	0.23	0.16***	0.00	0.02	-0.02	-0.07***	0.15***	-0.05***	
log(PAC)	0.10***	0.02	0.03	0.01	-0.03	-0.02	0.05***	0.06***	-0.02	-0.01	0.15***	0.01	-0.01

The sample consists of 3,557 firm-years with PAC expenditures between 1998 to 2008. All continuous variables are winsorized at the 1% and 99% level. All variables are measured at the end of fiscal year t unless noted otherwise. */**/*** represent statistical significance at 10%/5%/1% levels two-tailed. See Appendix A for variable definitions.

Table 4

Earnings response coefficients and investor perceptions of comprehensive lobbying

$CAR = \upsilon_0 + \upsilon_1 *E + \upsilon_2 *\Delta E + \upsilon_3 *LOBBY\_COMP + \upsilon_4 *E*LOBBY\_COMP + \upsilon_5 *\Delta E*LOBBY\_COMP + X*E*Control\ Variables + X*\Delta E*Control\ Variables + X*Control\ Variables$

	Coef.	*CAR*	p-value
Constant	(v_0)	-0.232**	(0.03)
E	(v_1)	3.030**	(0.02)
ΔE	(v_2)	-0.597	(0.61)
	($v_1 + v_2$)	**2.433***	**(0.09)**
LOBBY_COMP	(v_3)	-0.152	(0.11)
*E*LOBBY_COMP*	(v_4)	0.335	(0.70)
*ΔE*LOBBY_COMP*	(v_5)	-2.535***	(0.00)
	($v_4 + v_5$)	**-2.200*** **	**(0.00)**
Controls:			
*E*Firm Age* (v_6) / *ΔE*Firm Age* (v_7)	($v_6 + v_7$)	0.005	(0.21)
*E*Big 4* (v_8) / *ΔE*Big 4* (v_9)	($v_8 + v_9$)	-0.626	(0.17)
*E*Growth* (v_{10}) / *ΔE*Growth* (v_{11})	($v_{10} + v_{11}$)	0.259	(0.15)
*E*Persistence* (v_{12}) / *ΔE*Persistence* (v_{13})	($v_{12} + v_{13}$)	0.634***	(0.01)
*E*Volatility* (v_{14}) / *ΔE*Volatility* (v_{15})	($v_{14} + v_{15}$)	-0.687***	(0.00)
*E*Beta* (v_{16}) / *ΔE*Beta* (v_{17})	($v_{16} + v_{17}$)	-0.054	(0.77)
*E*Size* (v_{18}) / *ΔE*Size* (v_{19})	($v_{18} + v_{19}$)	0.207***	(0.00)
*E*Leverage* (v_{20}) / *ΔE*Leverage* (v_{21})	($v_{20} + v_{21}$)	-0.101	(0.89)
*E*Auditor Tenure* (v_{22}) / *ΔE*Auditor Tenure* (v_{23})	($v_{22} + v_{23}$)	-0.198	(0.17)
*E*log(PAC)* (v_{24}) / *ΔE*log(PAC)* (v_{25})	($v_{24} + v_{25}$)	-0.196	(0.44)
Firm Age	(v_{26})	0.000	(0.51)
Big4	(v_{27})	0.083**	(0.05)
Growth	(v_{28})	0.042***	(0.00)
Persistence	(v_{29})	-0.030	(0.17)
Volatility	(v_{30})	0.014	(0.44)
Beta	(v_{31})	-0.058	(0.14)
Size	(v_{32})	0.008	(0.54)
Leverage	(v_{32})	-0.076	(0.13)
Auditor Tenure	(v_{33})	0.014*	(0.09)
log(PAC)	(v_{34})	0.007	(0.51)
No. of Observations		3,557	
R^2		0.151	

The sample consists of 3,557 firm-year observations with PAC expenditures between 1998 and 2008. All variables are measured at the end of fiscal year t unless noted otherwise. */**/*** represent statistical significance at 10%/5%/1% levels two-tailed. p-values are in parentheses. All continuous variables are winsorized at the 1% and 99% level. See Appendix A for variable definitions.

Table 5

Panel A: Summary Statistics

Variable	Mean	Median	Std. Dev.	25%	75%
LOBBY_COMP	0.085	0.040	0.096	0.000	0.160
Restate	0.129	0.000	0.336	0.000	0.000
AAER	0.021	0.000	0.144	0.000	0.000
Going Concern	0.021	0.000	0.143	0.000	0.000
Dis. Accruals	-0.117	-0.026	7.344	-1.073	0.874
Dis. Current Accruals	-0.184	-0.035	4.625	-0.792	0.437
log(PAC)	9.145	10.434	4.006	8.700	11.623
Size	8.156	8.216	1.730	7.022	9.444
Book-to-Market	0.059	0.380	3.426	0.210	0.631
Leverage	0.637	0.620	0.247	0.488	0.761
ROA	0.037	0.048	0.124	0.009	0.093
Loss	0.204	0.000	0.403	0.000	0.000
Big4	0.966	1.000	0.182	1.000	1.000
Merger	0.486	0.000	0.500	0.000	1.000
Finance	0.236	0.000	0.424	0.000	0.000
Segments	2.251	2.236	0.696	1.732	2.646
Foreign Ops.	0.453	0.000	0.498	0.000	1.000
A/R_Inventory	0.272	0.241	0.183	0.131	0.372
Return	0.077	-0.005	0.618	-0.261	0.259
High Litigation	0.207	0.000	0.405	0.000	0.000

Table 5 (continued)

Panel B: Pearson correlation matrix

	LOBBY_ COMP	*Restate*	*AAER*	*Going Concern*	*Dis. Accruals*	*Dis. Current Accruals*	*log(PAC)*	*Size*	*Book-to-Market*	*Leverage*	*ROA*	*Loss*	*Big4*	*Merger*	*Finance*	*Segments*	*Foreign Ops.*	*A/R_Inventory*	*Return*
Restate	-0.03**																		
AAER	0.01	0.26***																	
Going Concern	-0.07***	-0.02	-0.02																
Dis. Accruals	0.01	0.00	-0.02	0.02															
Dis. Current Accruals	0.00	-0.01	-0.01	0.03	0.65***														
log(PAC)	0.54***	0.02*	0.04***	-0.06***	0.02	0.02													
Size	0.46***	0.03**	0.11***	-0.06***	-0.02	0.02	0.44***												
Book-to-Market	0.02	0.03*	0.02	-0.64***	0.00	0.00	0.02	0.00											
Leverage	-0.03**	0.03**	0.04***	0.39***	0.04***	0.01	0.06***	0.08***	-0.44***										
ROA	0.14***	-0.04***	-0.01	-0.29***	-0.02	-0.02	0.13***	0.19***	0.24***	-0.31***									
Loss	-0.15***	0.06***	0.02*	0.27***	0.02	0.03*	-0.12***	-0.16***	-0.21***	0.27***	-0.65***								
Big4	0.16***	0.04***	0.03*	0.00	-0.01	-0.02	0.13***	0.22***	-0.02	0.00	0.05***	-0.07***							
Merger	0.08***	0.01	0.04***	-0.10***	-0.03**	-0.02	0.10***	0.16***	0.10***	-0.08***	0.11***	-0.14***	0.10***						
Finance	-0.02	0.03*	0.00	0.00	0.02	0.02	-0.01	-0.03**	0.00	0.02	-0.04***	0.06***	0.01	-0.54***					
Segments	0.14***	0.04***	0.05***	-0.04***	-0.01	-0.02	0.21***	0.42***	0.00	0.00	0.11***	-0.06***	0.05***	0.17***	-0.08***				
Foreign Ops.	0.18***	-0.02*	0.03**	-0.08***	-0.02	-0.02*	0.15***	0.30***	0.04***	-0.09***	0.20***	-0.20***	0.12***	0.16***	-0.05***	0.41***			
A/R_Inventory	-0.08***	-0.01	0.05***	-0.03**	0.01	0.01	-0.10***	-0.17***	0.06***	-0.04***	0.17***	-0.17***	-0.02*	0.12***	-0.06***	0.08***	0.11***		
Return	-0.05***	0.00	-0.03**	-0.01	0.00	-0.03*	-0.05***	-0.09***	0.07***	-0.02	0.12***	-0.10***	0.01	-0.06***	0.11***	-0.04***	-0.02	0.04***	
High Litigation	0.16***	0.02	-0.01	-0.05***	-0.01	0.03**	0.03**	0.14***	0.01	-0.16***	0.09***	-0.06***	0.07***	0.00	0.00	-0.10***	0.05***	0.03*	-0.01

The sample consists of 4,868 firm-years with PAC expenditures between 1998 to 2008. All continuous variables are winsorized at the 1% and 99% level. All variables are measured at the end of fiscal year t unless noted otherwise. */**/*** represent statistical significance at 10%/5%/1% levels two-tailed. See Appendix A for variable definitions.

Table 6

Logistic regression of restatement on comprehensive lobbying and controls

Restate = γ_0 + γ_1 *LOBBY_COMP + *X* *Control Variables*

	Restate		*AAER*	
Constant	-3.633***	(0.00)	-22.717***	(0.00)
LOBBY_COMP	-2.859***	(0.00)	-2.760*	(0.08)
log(PAC)	0.026	(0.22)	0.015	(0.75)
Size	0.049	(0.42)	0.605***	(0.00)
Book-to-Market	0.064**	(0.03)	0.226	(0.17)
Leverage	0.546	(0.11)	0.917	(0.40)
ROA	-0.337	(0.58)	-0.666	(0.72)
Loss	0.433**	(0.01)	0.714**	(0.03)
Big4	0.340	(0.44)	12.616***	(0.00)
Merger	0.095	(0.53)	0.414	(0.34)
Finance	0.176	(0.19)	0.398	(0.36)
Segments	0.176	(0.18)	-0.340	(0.18)
Foreign Ops.	-0.155	(0.33)	0.199	(0.59)
A/R_Inventory	0.116	(0.81)	2.367***	(0.00)
Return	0.037	(0.53)	-0.206	(0.32)
High Litigation	0.395*	(0.07)	-0.237	(0.64)
No. of Observations	4,868		4,868	
No. of RESTATE or AAER	640		109	
Pseudo R^2	0.025		0.115	

The sample consists of 4,868 firm-years with PAC expenditures between 1998 to 2008. */**/*** represent statistical significance at 10%/5%/1% levels two-tailed. p-values are in parentheses. All continuous variables are winsorized at the 1% and 99% level. See Appendix A for variable definitions.

Table 7

Univariate statistics based on propensity score matching firms in the highest quintile of *LOBBY_COMP* and nonhighest quintile of *LOBBY_COMP*

	Firms in the highest quintile of *LOBBY_COMP* (n=769)	Firms in the nonhighest quintile of *LOBBY_COMP* (n=769)
Variable	**Mean**	**Mean**
Restate	0.04*	0.06
AAER	0.02***	0.04
log(PAC)	11.87	11.92
Size	9.37	9.44
Book-to-Market	0.23	0.19
ROA	0.06	0.06
Leverage	0.62	0.62
Loss	0.10	0.11
Return	0.03	0.02

The sample consists of 1,538 firm-years with PAC expenditures between 1998 to 2008. The sample is split into two groups based on *LOBBY_COMP* . Those firms in the highest quintile of *LOBBY_COMP* are propensity score matched to firms in the nonhighest quntile of *LOBBY_COMP* based on *log(PAC), Size, Book-to-Market, ROA, Leverage, Loss, and Return.* */**/*** represent statistical significance at 10%/5%/1% levels two-tailed. p-values are in parentheses. All continuous variables are winsorized at the 1% and 99% level. See Appendix A for variable definitions.

Table 8

Logistic regression of going concern on comprehensive lobbying and controls

Going Concern = $\gamma_0 + \gamma_1$ *LOBBY_COMP + X *Control Variables*

	Going Concern	
Constant	-11.23***	(0.00)
LOBBY_COMP	-4.73	(0.19)
log(PAC)	0.06	(0.29)
Lagged Going Concern	2.49***	(0.00)
Big4	2.61**	(0.02)
Prob(Bankruptcy)	-0.10**	(0.05)
Size	-0.11	(0.39)
Return	-0.41**	(0.02)
Leverage	5.51***	(0.00)
Δ*Leverage*	-0.49	(0.45)
Loss	0.29	(0.48)
Firm Age	0.02	(0.34)
Investments	0.91	(0.54)
Financing	-0.33	(0.36)
CFO	-4.92	(0.36)
Reporting Lag	0.00**	(0.02)
No. of Observations	898	
No. of Going Concerns	70	
Pseudo R^2	0.517	

The sample consists of 898 financially distressed firm-years with PAC expenditures between 1998 to 2008. Financially distressed companies are defined as companies with negative earnings or negative cash flows in year t. All variables are measured at the end of fiscal year t unless noted otherwise. */**/*** represent statistical significance at 10%/5%/1% levels two-tailed. p-values are in parentheses. All continuous variables are winsorized at the 1% and 99% level. See Appendix A for variable definitions.

Table 9

Regression of signed performance adjusted discretionray accruals and discretionary current accruals on comprehensive lobbying and controls

Dis. Accruals $= \gamma_0 + \gamma_1$ **LOBBY_COMP + X *Control Variables*

	Dis. Accruals		*Dis. Current Accruals*	
Constant	0.246	(0.86)	0.035	(0.96)
LOBBY_COMP	0.921	(0.52)	-0.523	(0.59)
log(PAC)	0.058*	(0.10)	0.026	(0.26)
Size	-0.170**	(0.04)	0.040	(0.44)
Book-to-Market	0.053	(0.30)	-0.004	(0.87)
Leverage	1.236*	(0.05)	-0.024	(0.95)
Loss	-0.102	(0.75)	0.069	(0.74)
Big4	-0.255	(0.81)	-0.612	(0.27)
Merger	-0.357	(0.17)	-0.114	(0.50)
Financing	0.061*	(0.84)	0.181	(0.37)
CFO	-0.997	(0.59)	-1.906*	(0.10)
Lagged Accruals	-2.024	(0.30)	0.938	(0.38)
High Litigation	0.109	(0.71)	0.412**	(0.01)
No. of Observations	4,868		4,868	
Adj. R^2	0.023		0.018	

The sample consists of 4,868 firm-years with PAC expenditures between 1998 to 2008. */**/*** represent statistical significance at 10%/5%/1% levels two-tailed. p-values are in parentheses. All continuous variables are winsorized at the 1% and 99% level. See Appendix A for variable definitions.